

ILLINOIS COMMERCE COMMISSION

DOCKET NO. 13-____

Direct Testimony of

PAUL J. HANLEY

Submitted on Behalf of
Aqua Illinois, Inc.

April 30, 2013

Aqua Exhibit 1.0

ILLINOIS COMMERCE
COMMISSION
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ILLINOIS COMMERCE COMMISSION

DOCKET NO. 13-____

DIRECT TESTIMONY OF

PAUL J. HANLEY

Submitted on Behalf of

AQUA ILLINOIS, INC.

I. INTRODUCTION AND BACKGROUND

Q. Please state your name and business address.

A. Paul J. Hanley, 1000 South Schuyler Avenue, Kankakee, Illinois, 60901.

Q. By whom are you employed and in what capacity?

A. I am the Controller for Aqua Illinois, Inc. ("Aqua" or the "Company").

Q. Please state your educational, professional and business background and experience.

A. I am a Certified Public Accountant ("CPA"), with a degree in accountancy from the University of Illinois. I am a member of the American Institute of Certified Public Accountants and the Illinois CPA Society. Since receiving my Accountancy degree, I have held three positions as an accountant, with increasing levels of responsibility, culminating in my current position with Aqua.

Q. What are your responsibilities as Controller of Aqua?

A. As Controller, I am responsible for supervising the financial operations for Aqua. These duties include overseeing the budget, forecasting, overseeing rates and supervising the day-to-day financial operations of the Company.

23 Q. Are you generally familiar with the operations, books, and records of Aqua?

24 A. Yes.

25 Q. Have you previously testified in regulatory proceedings before the Illinois
26 Commerce Commission (the “Commission”)?

27 A. Yes. Most recently, I submitted testimony on behalf of Aqua in Commission Docket
28 Nos. 12-0194, 12-0334, 12-0219, and 12-0467.

29 **II. PURPOSE OF TESTIMONY**

30 Q. What is the purpose of your testimony in this proceeding?

31 A. In this proceeding, Aqua proposes to implement Qualifying Infrastructure Plant (“QIP”)
32 surcharge riders in its Willowbrook Water, Willowbrook and Candlewick Sewer, University
33 Park Water, University Park and Tri-Star Estates Sewer, Candlewick and Fairhaven Estates
34 Water, Oak Run Water, and Ellwood Greens Sewer divisions. My testimony discusses the need
35 for the QIP surcharge and describes the proposed QIP surcharge riders. Rule 656.90(b) of the
36 Commission’s Rules, 83 Ill. Adm. Code 656.90(b), sets forth the information a utility must
37 submit to the Commission with a proposed QIP surcharge rider. My testimony also provides the
38 information required by Rules 656.90(b)(5), (7), and (8). Aqua witness Cameron Alden (Aqua
39 Exs. 2.0) provides the information required by Rules 656.90(b)(1) through (4) and (6).

40 Q. Are you providing any exhibits with your direct testimony?

41 A. Yes. I am offering the following exhibits:

- 42 • Aqua Exhibits 1.1-1.6 – Proposed tariffs establishing QIP surcharge riders for
43 Aqua’s Willowbrook Water, Willowbrook and Candlewick Sewer, University

Park Water, University Park and Tri-Star Estates Sewer, Candlewick and
Fairhaven Estates Water, Oak Run Water, and Ellwood Greens Sewer divisions;

- Aqua Exhibit 1.7 – Qualifying Infrastructure Plant Surcharge Revenue and Capital Calculation; and
- Aqua Exhibit 1.8 – Average Residential Water and Sewer Bill Comparison.

III. THE NEED FOR THE QIP SURCHARGE

Q. What is a QIP surcharge?

A. A QIP surcharge is a charge to recover return on and return of the capital costs related to replacement or rehabilitation of a water or sewer utility's qualified non-revenue producing plant infrastructure. Such investment includes replacement water and sewer mains, meters, water and sewer services, and hydrants. The surcharge applies only to qualified non-revenue producing investment, which has not yet been included in the utility's rate base in a rate case. It is capped at 5% of base rates billed to customers, and is annually reconciled to ensure that surcharge revenues collected are equal to the actual costs incurred by the utility related to QIP.

Q. What is the QIP surcharge Aqua proposes in this proceeding intended to accomplish?

A. Much of Aqua's distribution and collection system infrastructure in the above referenced divisions is nearing the end of its life expectancy and must be replaced. The Company recognizes that problem, and is taking steps to remedy it by replacing its aging infrastructure. Aqua, like other water utilities, must provide adequate, efficient, and reliable service that is least cost, consistent with those obligations. Aqua intends to meet this requirement and recover the cost of its investment in such infrastructure replacements, in part, through use of the proposed QIP surcharge. The surcharge will provide Aqua with the flexibility to take advantage of better

67 construction pricing through planned infrastructure investing, which will minimize construction
68 costs. As I discuss further below, the proposed QIP surcharge also can help reduce the frequency
69 of rate filings and the related rate case costs, which otherwise would be associated with the need
70 to recover investment in infrastructure replacement.

71 **Q. Please explain further why Aqua is proposing use of a QIP surcharge.**

72 **A.** As Aqua moves further into the 21st Century, it is not a question of whether or not the
73 capital investment in aging infrastructure will be made, but, rather, how can the ultimate impact
74 on the customers be minimized? Aqua believes the question is best answered through the QIP
75 surcharge program. Over the next several years, QIP projects will continue to be an increasing
76 part of Aqua's construction requirements. Furthermore, the capital and depreciation cost related
77 to the construction will require a significant level of rate relief in coming years. The proposed
78 QIP surcharge is intended to address this problem by permitting more time between necessary
79 rate filings, and therefore, potentially fewer rate cases.

80 **Q. What investments may be included in the QIP surcharge?**

81 **A.** For water utilities, the plant investments include replacements of existing worn out or
82 deteriorated plant items from the following accounts pursuant to 83 Ill. Adm. Code 605: (1)
83 Account 331, Transmission and Distribution Mains; (2) Account 333, Service; Account 334,
84 Meters and Meter Installations; and (4) Account 335, Hydrants. The plant investments are non-
85 revenue producing items that were installed after the conclusion of the test year in the
86 Company's last rate case and were not included in the calculation of the rate base in the
87 Company's last rate case. Other investments that would be included are (1) main extensions
88 installed to eliminate dead ends; and (2) unreimbursed costs associated with relocations of mains,
89 services, and hydrants occasioned by street or highway construction.

For sewer utilities, the plant additions include the same types of items from above, but from the following accounts pursuant to 83 Ill. Adm. Code 650: (1) Account 360, Collecting Sewer – Force; (2) Account 361, Collecting Sewer – Gravity (including costs associated with manholes); and (3) Account 363, Services to Customers.

Also, QIP includes only plant additions installed on or after January 1 of the year in which the utility files its initial QIP surcharge rider in accordance with 83 Ill. Adm. Code 656.70 and 656.90.

Replacement of these plant items enhances water and sewer quality and system reliability, and allows compliance with governmental regulations, but produces no revenue from additional sales.

Q. Is Aqua able to postpone construction of QIP projects to reduce the frequency of necessary rate relief?

A. No. Efficiency and customer needs require that replacement mains, meters, services, hydrants, collection sewers, manholes, sewer services, and other non-revenue producing items be performed continuously. Such facilities must be placed in-service when they are needed by customers or required by law or regulation, irrespective of rate case timing. Personnel constraints and labor efficiency also dictate that multiple projects be carried out on a regular basis to avoid inefficiencies resulting from increased overtime expense or the need to hire additional employees.

Q. Please explain further how the QIP surcharge reduces the frequency of rate filings.

A. As the Commission is aware, the placement in service of new plant additions is one of the major factors driving the need for water and sewer utilities to seek increases in revenues. With the approval of the proposed QIP surcharge riders, Aqua would be in a better position to absorb

113 increases in non-QIP costs for a longer period, particularly during times of relatively low
114 inflation. This allows for potentially longer periods between rate cases, and a resulting reduction
115 in associated rate case administrative costs over time, including the costs of consultants, legal
116 fees and, potentially, the costs of regulatory assessments. In addition, the proposed QIP
117 surcharge riders would provide for more gradual rate increases over time.

118 **Q. Why doesn't installation of QIP facilities result in additional revenue?**

119 **A.** As noted above, QIP facilities maintain quality and system reliability and/or permit
120 compliance with governmental requirements, but do not produce new revenue from additional
121 water or sewer sales. As a result, the installation of such facilities causes an unavoidable
122 increase in rate base and capitalization, with no offsetting revenue to support such additions.
123 Under traditional rate base/rate-of-return regulation, the filing of a rate proceeding is necessary
124 to enable the Company to recover the return on and return of investment in QIP facilities.

125 **Q. Will Aqua be required to attract capital to finance QIP construction?**

126 **A.** Yes, it may be necessary to look outside Aqua for additional capital. However, Aqua will
127 monitor its equity to debt position in order to determine the source of the capital. The
128 Company's implementation of the proposed QIP surcharge riders and anticipated infrastructure
129 improvements will not adversely impact Aqua's capital plan and capital structure. Aqua's goal
130 is to attain a capital structure of 53% equity and 47% debt, with an allowed return on equity of
131 no less than 9.49%, as previously approved by the Commission in Docket No. 11-0436.

132 Q. Were any of the projects identified as QIP in this proceeding reflected in the test
133 year in Aqua's last rate case?

134 A. No. In Aqua's last rate case, Docket No. 11-0436, Aqua used a future test year ending
135 2012. None of the QIP projects will be placed in service until after the test year ending 2012,
136 and therefore, none were included in the test year utility plant in service.

137 IV. **THE PROPOSED QIP SURCHARGE RIDERS**

138 Q. Please generally describe the QIP surcharge riders Aqua is proposing in this
139 proceeding.

140 A. The proposed QIP surcharge riders provide for a charge to cover return on and return of
141 the capital costs related to replacement or rehabilitation of qualified non-revenue producing plant
142 infrastructure. Such investment includes replacement water and sewer mains, meters, water and
143 sewer services, and hydrants. The QIP surcharge would apply only to qualified non-revenue
144 producing investment, which has not yet been included in rate base in a rate case. The surcharge
145 is capped at 5% of base rates billed to customers. The proposed QIP surcharge riders include a
146 reconciliation to ensure that revenues collected under the riders are equal to the actual costs
147 incurred.

148 Q. Why is Aqua proposing to implement QIP surcharge riders specifically in the ten
149 divisions you identified above?

150 A. Aqua's experience with the current QIP surcharge in its Kankakee Water and Vermillion
151 Water divisions demonstrates QIP surcharge riders are an effective means to recover the capital
152 investment in qualifying infrastructure. Over the next several years and for the foreseeable
153 future, infrastructure replacement projects consistent with QIP will constitute an increasing part

154 of Aqua's construction requirements, not only in the divisions that currently have a QIP rider, but
155 also in all of Aqua's service divisions. The increase in QIP projects is mainly due to the
156 continued aging of all of Aqua's existing infrastructure, as I discussed above, and not just the
157 infrastructure in the divisions that currently have a QIP rider. Replacement of that infrastructure
158 is necessary to maintain a safe and reliable system. Therefore, Aqua believes extending its QIP
159 surcharge riders to the ten divisions is necessary. I discuss each of the proposed QIP surcharge
160 riders below.

161 **Q. Will the proposed QIP surcharge riders function similarly to the QIP surcharge**
162 **riders currently in effect in the Kankakee Water and Vermilion Water divisions?**

163 **A.** Yes. The proposed riders will operate in exactly the same manner as the current QIP
164 surcharge riders approved by the Commission in Docket No. 01-0561.

165 **Q. Will implementation of the proposed QIP surcharge riders in the above divisions**
166 **result in fair, just, and reasonable rates?**

167 **A.** Yes. The proposed QIP surcharge riders operate only to provide a return on and return of
168 the investment in QIP. Moreover, the QIP surcharge is subject to a 5% cap. Also, Aqua
169 proposes that QIP surcharge revenue be refunded to ratepayers to the extent that such revenue
170 results in a rate of return for a given year that exceeds the authorized level. For these reasons,
171 the proposed QIP surcharge riders will result in fair, just, and reasonable rates.

172 Q. **Please describe the proposed Willowbrook Water Division and Oak Run Water**
173 **Division QIP Surcharge Rider.**

174 A. Aqua proposes that the existing Vermilion Division QIP Surcharge Rider (ILL. C.C. No.
175 49, Section No. 2, Sheet Nos. 19 through 32) be applied to the Willowbrook and Oak Run Water
176 Divisions. Please see Aqua Exhibit 1.1 for the proposed updated tariffs.

177 Q. **Please describe the proposed University Park Water Division QIP Surcharge Rider.**

178 A. Aqua proposes the QIP Surcharge Rider attached as Aqua Exhibit 1.2 for its University
179 Park Water Division. The new QIP Surcharge Rider is proposed as ILL. C.C. No. 49, Section
180 No. 3, Sheet Nos. 23 through 36, which is essentially identical to ILL. C.C. No. 49, Section No.
181 2, Sheet Nos. 19 through 32.

182 Q. **Please describe the proposed Candlewick Water Division and Fairhaven Estates**
183 **Water Division QIP Surcharge Rider.**

184 A. Aqua proposes the QIP Surcharge Rider attached as Aqua Exhibit 1.3 for its Candlewick
185 Water Division and Fairhaven Estates Water Division. The new QIP Surcharge Rider is
186 proposed as ILL. C.C. No. 49, Section No. 4, Sheet Nos. 20 through 33, which is essentially
187 identical to ILL. C.C. No. 49, Section No. 2, Sheet Nos. 19 through 32.

188 Q. **Please describe the proposed Willowbrook Sewer Division and Candlewick Sewer**
189 **Division QIP Surcharge Rider.**

190 A. Aqua proposes the QIP Surcharge Rider attached as Aqua Exhibit 1.4 for its Willowbrook
191 Sewer Division and Candlewick Sewer Division. The new QIP Surcharge Rider is proposed as
192 ILL. C.C. No. 50, Section No. 2, Sheet Nos. 14 through 27.

193 Q. **Please describe the proposed Tri-Star Estates Sewer Division and University Park**
194 **Sewer Division QIP Surcharge Rider.**

195 A. Aqua proposes the QIP Surcharge Rider attached as Aqua Exhibit 1.5 for its Tri-Star
196 Estates Sewer Division and University Park Sewer Division. The new QIP Surcharge Rider is
197 proposed as ILL. C.C. No. 50, Section No. 3, Sheet Nos. 15 through 28.

198 Q. **Please describe the proposed Ellwood Green Sewer Division QIP Surcharge Rider.**

199 A. Aqua proposes the QIP Surcharge Rider attached as Aqua Exhibit 1.6 for its Ellwood
200 Green Sewer Division. The new QIP Surcharge Rider is proposed as ILL. C.C. No. 50, Section
201 No. 4, Sheet Nos. 8 through 21.

202 V. **PART 656 REQUIREMENTS**

203 Q. **How will the proposed QIP surcharge riders and infrastructure improvements be**
204 **implemented?**

205 A. Aqua will follow the applicable Commission Rules, set forth in 83 Ill. Adm. Code Part
206 656.

207 Q. **Please explain what has been done to give notice of this proceeding.**

208 A. In accordance with Rule 656.30(c) and Section 9-201 of the Public Utilities Act, 220
209 ILCS 5/9-201, notice of this filing will be mailed to each customer in the affected divisions in the
210 first bill following the filing. Also, notice has been posted in the Company's business office. In
211 addition, notice of this proceeding will be published in newspapers of general circulation in areas
212 where customers will be affected once each week for two consecutive weeks, the first
213 publication being within ten days of the filing. Aqua will provide proof of the required notices
214 with its rebuttal testimony in this proceeding.

215 Q. **Has Aqua conducted analyses of Aqua's water and sewer infrastructure**
216 **replacement requirements, as required by Rules 656.90(b)(1) through (4)?**

217 A. Yes. Company witness Mr. Alden (Aqua Ex. 2.0) discusses Aqua's infrastructure
218 replacement requirements, including a history of current replacement rates of qualifying plant,
219 the reason for each increase in the rate of replacement, and specific plans for future
220 replacements.

221 Q. **Has the Company prepared detailed computations of the expected revenue effects of**
222 **investment in QIP, as required by Rule 656.90(b)(5)?**

223 A. Yes. Aqua has utilized presently available information to develop a preliminary estimate
224 of the Surcharge Percentages and revenue generated from the proposed QIP surcharge riders.
225 Aqua Exhibit 1.7 contains eleven schedules showing a summary of QIP revenue, the QIP
226 Surcharge Rider Calculation, QIP Additions, and assumptions for rates and factors for each
227 division in this proposal for the years 2014 and 2015.

228 Q. **Has Aqua prepared a bill comparison showing the effect of the QIP surcharge for**
229 **each class of customer, as required by Rule 656.90(b)(8)?**

230 A. Yes. This information is provided in Aqua Exhibit 1.8. The bill comparison shows the
231 impact of the 5% maximum allowed increase as required by Rule 656.90(b)(8). It also shows the
232 typical meter size for the respective division consumption in a range of 1,000 gallons to 20,000
233 gallons, plus the average usage level for that division, and then calculates the average bill (by
234 usage level), proposed bill, dollar increase, and percentage rate increase, exclusive of the revenue
235 attributable to the public fire protection charges, as required by Rule 656.90(b)(8). However, I
236 note that fire protection charges can vary greatly with each bill. The impact on a customer's total
237 bill, with fire protection charges included, may be less than reflected on Aqua Exhibit 1.8.

238 Q. Has Aqua provided any other information and data that supports the approval of
239 the proposed QIP surcharge riders, as required by Rule 656.90(b)(7)?

240 A. Yes. Aqua's Petition, my testimony here, and Mr. Alden's testimony, and particularly
241 the discussion of the need for the QIP surcharge in the pertinent divisions, supports approval of
242 the proposed riders.

243 VI. CONCLUSION

244 Q. What do you conclude?

245 A. I conclude implementation of the QIP surcharge riders proposed by Aqua in this
246 proceeding are in the public interest and should be approved, for all of the reasons discussed
247 above.

248 Q. Does this conclude your direct testimony?

249 A. Yes.

AQUA ILLINOIS, INC.
CONSOLIDATED

ILL. C. C. No. 49
Section No. 2
Second Revised Sheet No. 19
Cancelling First Revised Sheet No. 19

Applies To: Refer to Section No. 2, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- * Applicable to all water service customers in the Vermilion, Willowbrook and Oak Run Divisions.

Purpose

The purpose of the Qualifying Infrastructure Plant Surcharge ("QIPS") is to recover a return on, and depreciation expense related to, the investment in Qualifying Infrastructure Plant ("QIP") as described in the "Terms and Conditions" below. The QIPS rider is authorized by Section 9-220.2 of the Public Utilities Act [220 ILCS 5/9-220.2] and in accordance with 83 Ill. Adm. Code 656.

Application

The QIPS shall be capped at 5% of the QIP base rate revenues billed to customers. QIP base rate revenues shall include revenues recorded in accounts 460, 461, 462, 464, 465, 466, and 469 as described in 83 Ill. Adm. Code 605. The QIP surcharge shall not be applied to any add-on taxes or to any revenues attributable to the Purchased Water and Sewage Treatment Surcharges developed pursuant to 83 Ill. Adm. Code 655.

The QIPS shall be presented as a separate line item on customer bills. Also, the revenues resulting from each QIP surcharge rider shall be recorded in a separate revenue subaccount for each rate zone. The QIPS percentage shall be expressed as a percentage carried to two decimal places. The QIPS percentage shall be applied to the total amount billed to each customer located in the same rate zone based on the Company's otherwise applicable rates and charges. The QIPS percentage shall not be applied to the exclusions listed above. For purposes of this Rider, the "utility" or "Company" is Aqua Illinois, Inc. The "rate zone" is the Company's

- * Vermilion, Willowbrook, and Oak Run Divisions.

- * Indicates Changes in Tariff

Filed in Compliance with the Order of the
Illinois Commerce Commission in Docket No. _____

Issued: _____

Effective: _____

Issued By: Terry J. Rakocy, President
1000 S. Schuyler Ave., Kankakee, IL 60901

AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 23

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Applicable to all water service customers in Section No. 3.

Purpose

The purpose of the Qualifying Infrastructure Plant Surcharge ("QIPS") is to recover a return on, and depreciation expense related to, the investment in Qualifying Infrastructure Plant ("QIP") as described in the "Terms and Conditions" below. The QIPS rider is authorized by Section 9-220.2 of the Public Utilities Act [220 ILCS 5/9-220.2] and in accordance with 83 Ill. Adm. Code 656.

Application

The QIPS shall be capped at 5% of the QIP base rate revenues billed to customers. QIP base rate revenues shall include revenues recorded in accounts 460, 461, 462, 464, 465, 466, and 469 as described in 83 Ill. Adm. Code 605. The QIP surcharge shall not be applied to any add-on taxes or to any revenues attributable to the Purchased Water and Sewage Treatment Surcharges developed pursuant to 83 Ill. Adm. Code 655.

The QIPS shall be presented as a separate line item on customer bills. Also, the revenues resulting from each QIP surcharge rider shall be recorded in a separate revenue subaccount for each rate zone. The QIPS percentage shall be expressed as a percentage carried to two decimal places. The QIPS percentage shall be applied to the total amount billed to each customer located in the same rate zone based on the Company's otherwise applicable rates and charges. The QIPS percentage shall not be applied to the exclusions listed above.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 24

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Effective Date

The QIPS shall become effective for service provided on and after the first day of the month following the month in which a QIPS Percentage Information Sheet is filed with the Commission pursuant to the section set forth below.

QIPS Operation

The QIPS percentage shall be filed on an information sheet with supporting data no later than the 20th day of the month preceding the effective date of the QIPS percentage. An information sheet with supporting data filed after that date, but prior to the effective date, shall be accepted only if it corrects an error or errors from a timely filed information sheet for the same effective date. Any other information sheet with supporting data shall be accepted only if submitted as a special permission request to become effective on less than 45 days notice under the provisions of Section 9-201(a) of the Act.

The Company may file its initial information sheet with a QIPS percentage for the initial operation year with an effective date of the first day of any month. The effective date of any subsequent information sheet with a QIPS percentage is January 1 (and April 1 if the R component is modified). The Company may, at its option, file an information sheet modifying the QIP surcharge percentage, with an effective date of the first day of any month during the operation year, when necessary to recognize a material change in assumptions used in developing the QIP surcharge percentage (including, but not limited to, a change in depreciation rates). The Company shall also file an information sheet to implement a Commission-ordered O component.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 25

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Recoverable Qualifying Infrastructure Plant Costs

QIP costs shall include the pre-tax return on QIP and the net depreciation expense applicable to QIP.

- 1) The pre-tax return is calculated using the weighted cost of debt and weighted cost of equity determined in the utility's last rate case. The weighted cost of equity is multiplied by the gross revenue conversion factor (GRCF). The product is then added to the weighted cost of debt to obtain the pre-tax return. The pre-tax return is calculated using the following formulas:

$$GRCF = \frac{1}{(1 - PPTRIT)(1 - SIT)(1 - FIT)}$$

$$PTR = ((WCCE + WCPE) \times GRCF) + WCLTD + WCSTD$$

Where:

GRCF = Gross Revenue Conversion Factor.

PPTRIT = Illinois Personal Property Tax Replacement Income Tax rate in effect at the time of the initial, annual, or quarterly filing.

SIT = Illinois State income tax rate in effect at the time of the initial, annual, or quarterly filing.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 26

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

FIT = Federal income tax rate in effect at the time of the initial, annual, or quarterly filing.

PTR = Pre-tax return.

WCCE = Weighted cost of common equity from the utility's last rate case.

WCPE = Weighted cost of preferred equity from the utility's last rate case.

WCLTD = Weighted cost of long-term debt from the utility's last rate case.

WCSTD = Weighted cost of short-term debt from the utility's last rate case.

- 2) Net depreciation expense shall be calculated by applying the approved depreciation rate for the rate zone to each category of QIP. The depreciation expense for QIP shall be reduced by the depreciation expense on the plant being replaced.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 27

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Determination of the Qualifying Infrastructure Plant Surcharge Percentage

In calculating the QIP surcharge percentage, the Company will utilize annual prospective operation.

The QIP surcharge percentage for the operation year is determined by the following formula:

$$S\% = \frac{(NetQIP \times PTR) + NetDep + (R \times 1.33) + ((O + INT) \times OM) \times 100\%}{PAR}$$

Where:

S% = QIP surcharge percentage.

NetQIP = The average forecasted cost of the investment in QIP for the rate zone for the operation year less forecasted accumulated depreciation in QIP for the rate zone for the operation year. The average forecasted cost of QIP, net of depreciation, shall be computed by using an average of 13 end-of-month balances of QIP and accumulated depreciation for the period from December 31 of the year preceding the operation year through December 31 of the operation year.

PTR = Pre-tax return as described above.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 28

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- NetDep = Net depreciation expense related to the average investment in QIP for the rate zone for the operation year. Depreciation expense shall be calculated by multiplying the average forecasted cost of the investment in QIP by plant account, net of retirements, by the approved depreciation rates for the respective accounts in which the specific items included in the average QIP investment are recorded. The average forecasted cost of the investment in QIP by plant account, net of retirements, shall be computed by using an average of 13 end-of-month balances of QIP by plant account and retirements for the period from December 31 of the year preceding the operation year through December 31 of the operation year.
- R = Utility-determined reconciliation component (R component) calculated for the reconciliation year under the reconciliation feature as described below. The reconciliation component shall be collected over nine months from April through December.
- O = The Commission-ordered adjustment component (O component).
- INT = The calculated interest attributable to the O component. This interest shall be calculated as described below.
- Om = The Commission-ordered O component multiplier. Om is a timing factor applied to the O component and the INT to allow for the collection of the O component and the INT over the remainder of the operation year. For example, if the O component and the INT were included in the QIP surcharge percentage on January 1, the Om would be 1.00. Similarly, if the O component and the INT were included in the QIP surcharge percentage on April 1, the Om would be 1.33.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 29

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

PAR = The projection of total water QIP base rate revenues, as applicable, for the rate zone for the period from January 1 through December 31. The projected revenue shall not include the exclusions listed above.

Terms and Conditions

To be classified as QIP, the plant additions must meet the following criteria: 1) The plant additions must be replacements of existing plant items from the accounts listed below; 2) Such replacements must be non-revenue producing; 3) Such replacements are installed to replace facilities that are worn out or deteriorated or to replace facilities that are obsolete and at the end of their useful service lives due to a change in law or a change in the regulations of a governmental agency; 4) Such replacements are installed after the conclusion of the test year in the utility's latest rate case; and 5) Such replacements were not included in the calculation of the rate base in the utility's last rate case.

The plant additions shall include items from the following accounts, pursuant to 83 Ill. Adm. Code 605: 1) Account 331, Transmission and Distribution Mains; 2) Account 333, Services; 3) Account 334, Meters and Meter Installations; and 4) Account 335, Hydrants.

In addition to replacements, the following items may be classified as QIP: main extensions recorded in Account 331 for water utilities that are constructed to eliminate dead ends and the unreimbursed costs recorded in the appropriate accounts listed in the preceding paragraph that are associated with relocations of mains, services, hydrants, and sewers occasioned by street or highway construction.

QIP shall include only plant additions installed on or after January 1 of the year in which the Company files its initial QIPS Rider.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 30

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Annual Reconciliation

- a) On or before March 15 of each year in which the Company had a QIPS in effect for all or part of the immediately preceding calendar year, the Company shall submit to the Commission an annual reconciliation regarding the results for the previous reconciliation year. The annual reconciliation shall be verified by an officer of the Company. As required by this Section, the annual reconciliation shall include a calculation of the R component necessary to adjust revenue collected under the QIPS Rider in effect for the rate zone during the reconciliation year to an amount equivalent to the actual level of prudently-incurred QIP cost for the reconciliation year. In the event that the earnings report filed under this Section for the rate zone shows that the Company's actual rate of return has exceeded the level authorized in the Company's last water general rate proceeding, then the R component shall include the credit required by subsections (c) and (d). Any adjustment made through the R component shall be in effect for nine months commencing on the April 1 immediately following submittal of the annual reconciliation.
- b) With the annual reconciliation, the Company shall file a petition seeking initiation of the annual reconciliation hearings required by Section 9-220.2 of the Act. After the hearing, the Commission shall determine the amount of the adjustment, if any, that should be made (through the O component) to the level of revenue collected by operation of the QIPS Rider for the rate zone during the reconciliation year, so that the amount of such revenue is equal to the actual level of prudently-incurred QIP cost for the reconciliation year (to the extent that such adjustment has not already been reflected through an adjustment made by the Company to the R component of the QIP surcharge percentage).

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 31

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- c) In the annual reconciliation, the Company shall include, for each rate zone in which a QIP surcharge has been in effect, data showing operating income and rate base for the reconciliation year, such data being developed in accordance with (f)(4) below. If, for any such rate zone, the actual rate of return on rate base for the reconciliation year exceeds the overall rate of return allowed in the utility's last water general rate proceeding, revenues collected under the QIP surcharge rider shall be reflected as a credit through the R component of the QIP surcharge to the extent that such revenues contributed to the realization of a rate of return above the last approved level. A credit value for the R component will result in a reduction of the QIP surcharge percentage. To the extent, if any, that a required adjustment for a reconciliation year has not been already made by the Company (through the R component), the Commission shall require (through the O component) that such an adjustment be made after the annual reconciliation hearing.
- d) The Company will calculate the R component using the following formula:

$$R = (\text{ActNetQIP} \times \text{PTR}) + \text{ActNetDep} - \text{QIPRev} + \text{Rpy} + \text{Opy} - \text{EEA}$$

Where:

R = Utility-determined reconciliation component.

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AQUA ILLINOIS, INC.
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Original Sheet No. 32

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

ActNetQIP = The average actual cost of the investment in QIP for the rate zone for the reconciliation year less actual accumulated depreciation of QIP for the rate zone for the reconciliation year. The average actual cost of QIP, net of depreciation, shall be computed by using an average of 13 end-of-month balances of QIP and accumulated depreciation for the period from December 31 of the year preceding the reconciliation year through December 31 of the reconciliation year.

PTR = Pre-tax return as described above.

ActNetDep = Actual net depreciation expense related to the average investment in QIP for the rate zone for the reconciliation year. Depreciation expense shall be calculated by multiplying the actual investment in QIP by plant account, net of retirements, by the approved depreciation rates for the respective accounts in which the specific items included in the average QIP investment are recorded.

QIPRev = Actual QIP revenues for the rate zone collected during the reconciliation year through the QIPS.

Rpy = The R component for the rate zone from the previous reconciliation year.

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AQUA ILLINOIS, INC.
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Section No. 3
Original Sheet No. 33

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Opy = The sum of the O component and the calculated interest attributable to the O component, or the sum of any O components and the calculated interest attributable to the O components, included in the calculation of the QIP surcharge percentage during the reconciliation year.

EEA = Excess earnings amount calculated in accordance with subsections (a), (c), and (f) (4) of this Section. There will only be an EEA when the utility's actual rate of return for the reconciliation year exceeds the overall rate of return authorized by the Commission in the utility's last water rate proceeding.

- e) Any adjustment made by Order of the Commission under (b) or (c) above shall be included in the O component and be in effect for either 12 months or nine months, beginning on the next January 1 (if 12 months) or April 1 (if nine months) following the Order of the Commission, or such other period as the Commission may direct in the Order requiring that an adjustment be made.
- f) Each annual reconciliation shall include the following schedules:
 - 1) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the QIP costs for the reconciliation year;

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 34

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- 2) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the revenues arising through the application of the QIP surcharge during the reconciliation year;
- 3) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the reconciliation component determined by the utility showing the amount to be recovered or refunded over a nine-month period commencing on April 1; and
- 4) Schedules showing the utility's calculation of actual operating income and 13-month average rate base for the reconciliation year by rate zone. This calculation of actual operating income and 13-month average rate base shall be adjusted for any applicable adjustments accepted by the Commission in the utility's last rate case. In calculating the amount of federal and State income tax expense reflected in operating income, the utility shall reflect as deductible interest expense for tax purposes the product that results when the weighted embedded cost-of-debt reflected in the overall rate of return calculation used in the utility's last rate proceeding is multiplied by the rate base for the applicable rate zone as shown in the annual reconciliation.

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 35

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

In the event that the actual rate of return for any rate zone exceeds the rate of return allowed in the utility's last water or sewer general rate proceeding, a schedule showing the extent to which revenues provided by operation of the QIP surcharge contributed to the difference between the actual and last-authorized rate of return also shall be provided. The amount of the revenues provided by the QIP surcharge that contributed to the actual rate of return exceeding the overall rate of return authorized by the Commission in the utility's last water and sewer rate proceeding shall be included as a credit in the calculation of the R component.

- g) The first reconciliation year shall begin on the effective date of the first QIP surcharge information sheet and end on December 31 of the calendar year in which the first information sheet became effective. Each subsequent reconciliation year shall end on December 31.
- h) When the utility files its annual reconciliation, the utility shall provide copies of the following items to the Commission's Manager of the Water Department and to the Commission's Manager of the Accounting Department.
 - 1) Copies of all workpapers pertaining to the reconciliation;
 - 2) A detailed summary of all invoices supporting the costs for eligible QIP surcharge projects;

* Indicates Changes in Tariff

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AQUA ILLINOIS, INC.
UNIVERSITY PARK

ILL. C. C. No. 49
Section No. 3
Original Sheet No. 36

Applies To: Refer to Section No. 3, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- 3) Copies of the applicable general ledger or comparable material supporting the recovery of the QIP surcharge;
 - 4) A detailed worksheet showing the calculation of any utility-determined reconciliation component (R component) amount based upon the annual reconciliation; and
 - 5) Information regarding the prudence of the utility's investment in QIP.
-
- i) Amounts either collected or refunded through the O component shall accrue interest at the rate established by the Commission under 83 Ill. Adm. Code 280.70 (e) (1). Interest on the O component shall be applied from the end of the reconciliation year until the O component is refunded or charged to ratepayers through the QIPS.
 - j) If, for a rate zone, the annual reconciliation filed by a utility shows that the revenues collected by application of the QIP surcharge rider exceed actual QIP costs for three or more consecutive reconciliation years, the Commission may initiate hearings under Section 9-250 of the Act [220 ILCS 5/9-250] to determine whether the utility's QIPS rider for the rate zone should be canceled.

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AQUA ILLINOIS, INC.
CANDLEWICK
FAIRHAVEN

ILL. C. C. No. 49
Section No. 4
Original Sheet No. 20

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Applicable to all water service customers in Section No. 4

Purpose

The purpose of the Qualifying Infrastructure Plant Surcharge ("QIPS") is to recover a return on, and depreciation expense related to, the investment in Qualifying Infrastructure Plant ("QIP") as described in the "Terms and Conditions" below. The QIPS rider is authorized by Section 9-220.2 of the Public Utilities Act [220 ILCS 5/9-220.2] and in accordance with 83 Ill. Adm. Code 656.

Application

The QIPS shall be capped at 5% of the QIP base rate revenues billed to customers. QIP base rate revenues shall include revenues recorded in accounts 460, 461, 462, 464, 465, 466, and 469 as described in 83 Ill. Adm. Code 605. The QIP surcharge shall not be applied to any add-on taxes or to any revenues attributable to the Purchased Water and Sewage Treatment Surcharges developed pursuant to 83 Ill. Adm. Code 655.

The QIPS shall be presented as a separate line item on customer bills. Also, the revenues resulting from each QIP surcharge rider shall be recorded in a separate revenue subaccount for each rate zone. The QIPS percentage shall be expressed as a percentage carried to two decimal places. The QIPS percentage shall be applied to the total amount billed to each customer located in the same rate zone based on the Company's otherwise applicable rates and charges. The QIPS percentage shall not be applied to the exclusions listed above.

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AQUA ILLINOIS, INC.
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Section No. 4
Original Sheet No. 21

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Effective Date

The QIPS shall become effective for service provided on and after the first day of the month following the month in which a QIPS Percentage Information Sheet is filed with the Commission pursuant to the section set forth below.

QIPS Operation

The QIPS percentage shall be filed on an information sheet with supporting data no later than the 20th day of the month preceding the effective date of the QIPS percentage. An information sheet with supporting data filed after that date, but prior to the effective date, shall be accepted only if it corrects an error or errors from a timely filed information sheet for the same effective date. Any other information sheet with supporting data shall be accepted only if submitted as a special permission request to become effective on less than 45 days notice under the provisions of Section 9-201(a) of the Act.

The Company may file its initial information sheet with a QIPS percentage for the initial operation year with an effective date of the first day of any month. The effective date of any subsequent information sheet with a QIPS percentage is January 1 (and April 1 if the R component is modified). The Company may, at its option, file an information sheet modifying the QIP surcharge percentage, with an effective date of the first day of any month during the operation year, when necessary to recognize a material change in assumptions used in developing the QIP surcharge percentage (including, but not limited to, a change in depreciation rates). The Company shall also file an information sheet to implement a Commission-ordered O component.

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Section No. 4
Original Sheet No. 22

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Recoverable Qualifying Infrastructure Plant Costs

QIP costs shall include the pre-tax return on QIP and the net depreciation expense applicable to QIP.

- 1) The pre-tax return is calculated using the weighted cost of debt and weighted cost of equity determined in the utility's last rate case. The weighted cost of equity is multiplied by the gross revenue conversion factor (GRCF). The product is then added to the weighted cost of debt to obtain the pre-tax return. The pre-tax return is calculated using the following formulas:

$$GRCF = \frac{1}{(1 - PPTRIT)(1 - SIT)(1 - FIT)}$$

$$PTR = ((WCCE + WCPE) \times GRCF) + WCLTD + WCSTD$$

Where:

GRCF = Gross Revenue Conversion Factor.

PPTRIT = Illinois Personal Property Tax Replacement Income Tax rate in effect at the time of the initial, annual, or quarterly filing.

SIT = Illinois State income tax rate in effect at the time of the initial, annual, or quarterly filing.

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Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- FIT = Federal income tax rate in effect at the time of the initial, annual, or quarterly filing.
- PTR = Pre-tax return.
- WCCE = Weighted cost of common equity from the utility's last rate case.
- WCPE = Weighted cost of preferred equity from the utility's last rate case.
- WCLTD = Weighted cost of long-term debt from the utility's last rate case.
- WCSTD = Weighted cost of short-term debt from the utility's last rate case.

- 2) Net depreciation expense shall be calculated by applying the approved depreciation rate for the rate zone to each category of QIP. The depreciation expense for QIP shall be reduced by the depreciation expense on the plant being replaced.

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Section No. 4
Original Sheet No. 24

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Determination of the Qualifying Infrastructure Plant Surcharge Percentage

In calculating the QIP surcharge percentage, the Company will utilize annual prospective operation.

The QIP surcharge percentage for the operation year is determined by the following formula:

$$S\% = \frac{(NetQIP \times PTR) + NetDep + (R \times 1.33) + ((O + INT) \times OM) \times 100\%}{PAR}$$

Where:

S% = QIP surcharge percentage.

NetQIP = The average forecasted cost of the investment in QIP for the rate zone for the operation year less forecasted accumulated depreciation in QIP for the rate zone for the operation year. The average forecasted cost of QIP, net of depreciation, shall be computed by using an average of 13 end-of-month balances of QIP and accumulated depreciation for the period from December 31 of the year preceding the operation year through December 31 of the operation year.

PTR = Pre-tax return as described above.

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Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- NetDep = Net depreciation expense related to the average investment in QIP for the rate zone for the operation year. Depreciation expense shall be calculated by multiplying the average forecasted cost of the investment in QIP by plant account, net of retirements, by the approved depreciation rates for the respective accounts in which the specific items included in the average QIP investment are recorded. The average forecasted cost of the investment in QIP by plant account, net of retirements, shall be computed by using an average of 13 end-of-month balances of QIP by plant account and retirements for the period from December 31 of the year preceding the operation year through December 31 of the operation year.
- R = Utility-determined reconciliation component (R component) calculated for the reconciliation year under the reconciliation feature as described below. The reconciliation component shall be collected over nine months from April through December.
- O = The Commission-ordered adjustment component (O component).
- INT = The calculated interest attributable to the O component. This interest shall be calculated as described below.
- Om = The Commission-ordered O component multiplier. Om is a timing factor applied to the O component and the INT to allow for the collection of the O component and the INT over the remainder of the operation year. For example, if the O component and the INT were included in the QIP surcharge percentage on January 1, the Om would be 1.00. Similarly, if the O component and the INT were included in the QIP surcharge percentage on April 1, the Om would be 1.33.

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Section No. 4
Original Sheet No. 26

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

PAR = The projection of total water QIP base rate revenues, as applicable, for the rate zone for the period from January 1 through December 31. The projected revenue shall not include the exclusions listed above.

Terms and Conditions

To be classified as QIP, the plant additions must meet the following criteria: 1) The plant additions must be replacements of existing plant items from the accounts listed below; 2) Such replacements must be non-revenue producing; 3) Such replacements are installed to replace facilities that are worn out or deteriorated or to replace facilities that are obsolete and at the end of their useful service lives due to a change in law or a change in the regulations of a governmental agency; 4) Such replacements are installed after the conclusion of the test year in the utility's latest rate case; and 5) Such replacements were not included in the calculation of the rate base in the utility's last rate case.

The plant additions shall include items from the following accounts, pursuant to 83 Ill. Adm. Code 605: 1) Account 331, Transmission and Distribution Mains; 2) Account 333, Services; 3) Account 334, Meters and Meter Installations; and 4) Account 335, Hydrants.

In addition to replacements, the following items may be classified as QIP: main extensions recorded in Account 331 for water utilities that are constructed to eliminate dead ends and the unreimbursed costs recorded in the appropriate accounts listed in the preceding paragraph that are associated with relocations of mains, services, hydrants, and sewers occasioned by street or highway construction.

QIP shall include only plant additions installed on or after January 1 of the year in which the Company files its initial QIPS Rider.

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Original Sheet No. 27

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WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Annual Reconciliation

- a) On or before March 15 of each year in which the Company had a QIPS in effect for all or part of the immediately preceding calendar year, the Company shall submit to the Commission an annual reconciliation regarding the results for the previous reconciliation year. The annual reconciliation shall be verified by an officer of the Company. As required by this Section, the annual reconciliation shall include a calculation of the R component necessary to adjust revenue collected under the QIPS Rider in effect for the rate zone during the reconciliation year to an amount equivalent to the actual level of prudently-incurred QIP cost for the reconciliation year. In the event that the earnings report filed under this Section for the rate zone shows that the Company's actual rate of return has exceeded the level authorized in the Company's last water general rate proceeding, then the R component shall include the credit required by subsections (c) and (d). Any adjustment made through the R component shall be in effect for nine months commencing on the April 1 immediately following submittal of the annual reconciliation.
- b) With the annual reconciliation, the Company shall file a petition seeking initiation of the annual reconciliation hearings required by Section 9-220.2 of the Act. After the hearing, the Commission shall determine the amount of the adjustment, if any, that should be made (through the O component) to the level of revenue collected by operation of the QIPS Rider for the rate zone during the reconciliation year, so that the amount of such revenue is equal to the actual level of prudently-incurred QIP cost for the reconciliation year (to the extent that such adjustment has not already been reflected through an adjustment made by the Company to the R component of the QIP surcharge percentage).

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WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- c) In the annual reconciliation, the Company shall include, for each rate zone in which a QIP surcharge has been in effect, data showing operating income and rate base for the reconciliation year, such data being developed in accordance with (f)(4) below. If, for any such rate zone, the actual rate of return on rate base for the reconciliation year exceeds the overall rate of return allowed in the utility's last water general rate proceeding, revenues collected under the QIP surcharge rider shall be reflected as a credit through the R component of the QIP surcharge to the extent that such revenues contributed to the realization of a rate of return above the last approved level. A credit value for the R component will result in a reduction of the QIP surcharge percentage. To the extent, if any, that a required adjustment for a reconciliation year has not been already made by the Company (through the R component), the Commission shall require (through the O component) that such an adjustment be made after the annual reconciliation hearing.
- d) The Company will calculate the R component using the following formula:

$$R = (\text{ActNetQIP} \times \text{PTR}) + \text{ActNetDep} - \text{QIPRev} + \text{Rpy} + \text{Opy} - \text{EEA}$$

Where:

R = Utility-determined reconciliation component.

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WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

ActNetQIP = The average actual cost of the investment in QIP for the rate zone for the reconciliation year less actual accumulated depreciation of QIP for the rate zone for the reconciliation year. The average actual cost of QIP, net of depreciation, shall be computed by using an average of 13 end-of-month balances of QIP and accumulated depreciation for the period from December 31 of the year preceding the reconciliation year through December 31 of the reconciliation year.

PTR = Pre-tax return as described above.

ActNetDep = Actual net depreciation expense related to the average investment in QIP for the rate zone for the reconciliation year. Depreciation expense shall be calculated by multiplying the actual investment in QIP by plant account, net of retirements, by the approved depreciation rates for the respective accounts in which the specific items included in the average QIP investment are recorded.

QIPRev = Actual QIP revenues for the rate zone collected during the reconciliation year through the QIPS.

Rpy = The R component for the rate zone from the previous reconciliation year.

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WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Opy = The sum of the O component and the calculated interest attributable to the O component, or the sum of any O components and the calculated interest attributable to the O components, included in the calculation of the QIP surcharge percentage during the reconciliation year.

EEA = Excess earnings amount calculated in accordance with subsections (a), (c), and (f) (4) of this Section. There will only be an EEA when the utility's actual rate of return for the reconciliation year exceeds the overall rate of return authorized by the Commission in the utility's last water rate proceeding.

- e) Any adjustment made by Order of the Commission under (b) or (c) above shall be included in the O component and be in effect for either 12 months or nine months, beginning on the next January 1 (if 12 months) or April 1 (if nine months) following the Order of the Commission, or such other period as the Commission may direct in the Order requiring that an adjustment be made.
- f) Each annual reconciliation shall include the following schedules:
 - 1) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the QIP costs for the reconciliation year;

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AQUA ILLINOIS, INC.
CANDLEWICK
FAIRHAVEN

ILL. C. C. No. 49
Section No. 4
Original Sheet No. 31

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- 2) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the revenues arising through the application of the QIP surcharge during the reconciliation year;
- 3) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the reconciliation component determined by the utility showing the amount to be recovered or refunded over a nine-month period commencing on April 1; and
- 4) Schedules showing the utility's calculation of actual operating income and 13-month average rate base for the reconciliation year by rate zone. This calculation of actual operating income and 13-month average rate base shall be adjusted for any applicable adjustments accepted by the Commission in the utility's last rate case. In calculating the amount of federal and State income tax expense reflected in operating income, the utility shall reflect as deductible interest expense for tax purposes the product that results when the weighted embedded cost-of-debt reflected in the overall rate of return calculation used in the utility's last rate proceeding is multiplied by the rate base for the applicable rate zone as shown in the annual reconciliation.

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AQUA ILLINOIS, INC.
CANDLEWICK
FAIRHAVEN

ILL. C. C. No. 49
Section No. 4
Original Sheet No. 32

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

In the event that the actual rate of return for any rate zone exceeds the rate of return allowed in the utility's last water or sewer general rate proceeding, a schedule showing the extent to which revenues provided by operation of the QIP surcharge contributed to the difference between the actual and last-authorized rate of return also shall be provided. The amount of the revenues provided by the QIP surcharge that contributed to the actual rate of return exceeding the overall rate of return authorized by the Commission in the utility's last water and sewer rate proceeding shall be included as a credit in the calculation of the R component.

- g) The first reconciliation year shall begin on the effective date of the first QIP surcharge information sheet and end on December 31 of the calendar year in which the first information sheet became effective. Each subsequent reconciliation year shall end on December 31.
- h) When the utility files its annual reconciliation, the utility shall provide copies of the following items to the Commission's Manager of the Water Department and to the Commission's Manager of the Accounting Department.
 - 1) Copies of all workpapers pertaining to the reconciliation;
 - 2) A detailed summary of all invoices supporting the costs for eligible QIP surcharge projects;

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AQUA ILLINOIS, INC.
CANDLEWICK
FAIRHAVEN

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Section No. 4
Original Sheet No. 33

Applies To: Refer to Section No. 4, Sheet No. 1

WATER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- 3) Copies of the applicable general ledger or comparable material supporting the recovery of the QIP surcharge;
 - 4) A detailed worksheet showing the calculation of any utility-determined reconciliation component (R component) amount based upon the annual reconciliation; and
 - 5) Information regarding the prudence of the utility's investment in QIP.
-
- i) Amounts either collected or refunded through the O component shall accrue interest at the rate established by the Commission under 83 Ill. Adm. Code 280.70 (e) (1). Interest on the O component shall be applied from the end of the reconciliation year until the O component is refunded or charged to ratepayers through the QIPS.
 - j) If, for a rate zone, the annual reconciliation filed by a utility shows that the revenues collected by application of the QIP surcharge rider exceed actual QIP costs for three or more consecutive reconciliation years, the Commission may initiate hearings under Section 9-250 of the Act [220 ILCS 5/9-250] to determine whether the utility's QIPS rider for the rate zone should be canceled.

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Original Sheet No. 14

Applies To: Refer to Section No. 2, Sheet No. 1

SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Applicable to all sewer service customers in Willowbrook and Candlewick Divisions.

Purpose

The purpose of the Qualifying Infrastructure Plant Surcharge ("QIPS") is to recover a return on, and depreciation expense related to, the investment in Qualifying Infrastructure Plant ("QIP") as described in the "Terms and Conditions" below. The QIPS rider is authorized by Section 9-220.2 of the Public Utilities Act [220 ILCS 5/9-220.2] and in accordance with 83 Ill. Adm. Code 656.

Application

The QIPS shall be capped at 5% of the QIP base rate revenues billed to customers. QIP base rate revenues shall include revenues recorded in accounts 521, 522, 523, and 524 as described in 83 Ill. Adm. Code 650. The QIP surcharge shall not be applied to any add-on taxes or to any revenues attributable to the Purchased Sewer and Sewage Treatment Surcharges developed pursuant to 83 Ill. Adm. Code 655.

The QIPS shall be presented as a separate line item on customer bills. Also, the revenues resulting from each QIP surcharge rider shall be recorded in a separate revenue subaccount for each rate zone. The QIPS percentage shall be expressed as a percentage carried to two decimal places. The QIPS percentage shall be applied to the total amount billed to each customer located in the same rate zone based on the Company's otherwise applicable rates and charges. The QIPS percentage shall not be applied to the exclusions listed above. For purposes of this Rider, the "utility" or "Company" is Aqua Illinois, Inc. The "rate zone" is the Company's Willowbrook and Candlewick Divisions.

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Original Sheet No. 15

Applies To: Refer to Section No. 2, Sheet No. 1

SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Effective Date

The QIPS shall become effective for service provided on and after the first day of the month following the month in which a QIPS Percentage Information Sheet is filed with the Commission pursuant to the section set forth below.

QIPS Operation

The QIPS percentage shall be filed on an information sheet with supporting data no later than the 20th day of the month preceding the effective date of the QIPS percentage. An information sheet with supporting data filed after that date, but prior to the effective date, shall be accepted only if it corrects an error or errors from a timely filed information sheet for the same effective date. Any other information sheet with supporting data shall be accepted only if submitted as a special permission request to become effective on less than 45 days notice under the provisions of Section 9-201(a) of the Act.

The Company may file its initial information sheet with a QIPS percentage for the initial operation year with an effective date of the first day of any month. The effective date of any subsequent information sheet with a QIPS percentage is January 1 (and April 1 if the R component is modified). The Company may, at its option, file an information sheet modifying the QIP surcharge percentage, with an effective date of the first day of any month during the operation year, when necessary to recognize a material change in assumptions used in developing the QIP surcharge percentage (including, but not limited to, a change in depreciation rates). The Company shall also file an information sheet to implement a Commission-ordered O component.

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Original Sheet No. 16

Applies To: Refer to Section No. 2, Sheet No. 1

SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Recoverable Qualifying Infrastructure Plant Costs

QIP costs shall include the pre-tax return on QIP and the net depreciation expense applicable to QIP.

- 1) The pre-tax return is calculated using the weighted cost of debt and weighted cost of equity determined in the utility's last rate case. The weighted cost of equity is multiplied by the gross revenue conversion factor (GRCF). The product is then added to the weighted cost of debt to obtain the pre-tax return. The pre-tax return is calculated using the following formulas:

$$GRCF = \frac{1}{(1 - PPTRIT)(1 - SIT)(1 - FIT)}$$

$$PTR = ((WCCE + WCPE) \times GRCF) + WCLTD + WCSTD$$

Where:

GRCF = Gross Revenue Conversion Factor.

PPTRIT = Illinois Personal Property Tax Replacement Income Tax rate in effect at the time of the initial, annual, or quarterly filing.

SIT = Illinois State income tax rate in effect at the time of the initial, annual, or quarterly filing.

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

FIT = Federal income tax rate in effect at the time of the initial, annual, or quarterly filing.

PTR = Pre-tax return.

WCCE = Weighted cost of common equity from the utility's last rate case.

WCPE = Weighted cost of preferred equity from the utility's last rate case.

WCLTD = Weighted cost of long-term debt from the utility's last rate case.

WCSTD = Weighted cost of short-term debt from the utility's last rate case.

- 2) Net depreciation expense shall be calculated by applying the approved depreciation rate for the rate zone to each category of QIP. The depreciation expense for QIP shall be reduced by the depreciation expense on the plant being replaced.

* Indicates Changes in Tariff

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Applies To: Refer to Section No. 2, Sheet No. 1

SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Determination of the Qualifying Infrastructure Plant Surcharge Percentage

In calculating the QIP surcharge percentage, the Company will utilize annual prospective operation.

The QIP surcharge percentage for the operation year is determined by the following formula:

$$S\% = \frac{(NetQIP \times PTR) + NetDep + (R \times 1.33) + ((O + INT) \times OM) \times 100\%}{PAR}$$

Where:

S% = QIP surcharge percentage.

NetQIP = The average forecasted cost of the investment in QIP for the rate zone for the operation year less forecasted accumulated depreciation in QIP for the rate zone for the operation year. The average forecasted cost of QIP, net of depreciation, shall be computed by using an average of 13 end-of-month balances of QIP and accumulated depreciation for the period from December 31 of the year preceding the operation year through December 31 of the operation year.

PTR = Pre-tax return as described above.

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- NetDep = Net depreciation expense related to the average investment in QIP for the rate zone for the operation year. Depreciation expense shall be calculated by multiplying the average forecasted cost of the investment in QIP by plant account, net of retirements, by the approved depreciation rates for the respective accounts in which the specific items included in the average QIP investment are recorded. The average forecasted cost of the investment in QIP by plant account, net of retirements, shall be computed by using an average of 13 end-of-month balances of QIP by plant account and retirements for the period from December 31 of the year preceding the operation year through December 31 of the operation year.
- R = Utility-determined reconciliation component (R component) calculated for the reconciliation year under the reconciliation feature as described below. The reconciliation component shall be collected over nine months from April through December.
- O = The Commission-ordered adjustment component (O component).
- INT = The calculated interest attributable to the O component. This interest shall be calculated as described below.
- Om = The Commission-ordered O component multiplier. Om is a timing factor applied to the O component and the INT to allow for the collection of the O component and the INT over the remainder of the operation year. For example, if the O component and the INT were included in the QIP surcharge percentage on January 1, the Om would be 1.00. Similarly, if the O component and the INT were included in the QIP surcharge percentage on April 1, the Om would be 1.33.

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

PAR = The projection of total sewer QIP base rate revenues, as applicable, for the rate zone for the period from January 1 through December 31. The projected revenue shall not include the exclusions listed above.

Terms and Conditions

To be classified as QIP, the plant additions must meet the following criteria: 1) The plant additions must be replacements of existing plant items from the accounts listed below; 2) Such replacements must be non-revenue producing; 3) Such replacements are installed to replace facilities that are worn out or deteriorated or to replace facilities that are obsolete and at the end of their useful service lives due to a change in law or a change in the regulations of a governmental agency; 4) Such replacements are installed after the conclusion of the test year in the utility's latest rate case; and 5) Such replacements were not included in the calculation of the rate base in the utility's last rate case.

The plant additions shall include items from the following accounts, pursuant to 83 Ill. Adm. Code 650: 1) Account 360, Collecting Sewers – Force; 2) Account 361, Collecting Sewers – Gravity (including costs associated with manholes); and 3) Account 363, Services to Customers.

QIP shall include only plant additions installed on or after January 1 of the year in which the Company files its initial QIPS Rider.

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AQUA ILLINOIS, INC.
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Applies To: Refer to Section No. 2, Sheet No. 1

SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Annual Reconciliation

- a) On or before March 15 of each year in which the Company had a QIPS in effect for all or part of the immediately preceding calendar year, the Company shall submit to the Commission an annual reconciliation regarding the results for the previous reconciliation year. The annual reconciliation shall be verified by an officer of the Company. As required by this Section, the annual reconciliation shall include a calculation of the R component necessary to adjust revenue collected under the QIPS Rider in effect for the rate zone during the reconciliation year to an amount equivalent to the actual level of prudently-incurred QIP cost for the reconciliation year. In the event that the earnings report filed under this Section for the rate zone shows that the Company's actual rate of return has exceeded the level authorized in the Company's last sewer general rate proceeding, then the R component shall include the credit required by subsections (c) and (d). Any adjustment made through the R component shall be in effect for nine months commencing on the April 1 immediately following submittal of the annual reconciliation.
- b) With the annual reconciliation, the Company shall file a petition seeking initiation of the annual reconciliation hearings required by Section 9-220.2 of the Act. After the hearing, the Commission shall determine the amount of the adjustment, if any, that should be made (through the O component) to the level of revenue collected by operation of the QIPS Rider for the rate zone during the reconciliation year, so that the amount of such revenue is equal to the actual level of prudently-incurred QIP cost for the reconciliation year (to the extent that such adjustment has not already been reflected through an adjustment made by the Company to the R component of the QIP surcharge percentage).

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- c) In the annual reconciliation, the Company shall include, for each rate zone in which a QIP surcharge has been in effect, data showing operating income and rate base for the reconciliation year, such data being developed in accordance with (f)(4) below. If, for any such rate zone, the actual rate of return on rate base for the reconciliation year exceeds the overall rate of return allowed in the utility's last sewer general rate proceeding, revenues collected under the QIP surcharge rider shall be reflected as a credit through the R component of the QIP surcharge to the extent that such revenues contributed to the realization of a rate of return above the last approved level. A credit value for the R component will result in a reduction of the QIP surcharge percentage. To the extent, if any, that a required adjustment for a reconciliation year has not been already made by the Company (through the R component), the Commission shall require (through the O component) that such an adjustment be made after the annual reconciliation hearing.
- d) The Company will calculate the R component using the following formula:

$$R = (\text{ActNetQIP} \times \text{PTR}) + \text{ActNetDep} - \text{QIPRev} + \text{Rpy} + \text{Opy} - \text{EEA}$$

Where:

R = Utility-determined reconciliation component.

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Applies To: Refer to Section No. 2, Sheet No. 1

SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

ActNetQIP = The average actual cost of the investment in QIP for the rate zone for the reconciliation year less actual accumulated depreciation of QIP for the rate zone for the reconciliation year. The average actual cost of QIP, net of depreciation, shall be computed by using an average of 13 end-of-month balances of QIP and accumulated depreciation for the period from December 31 of the year preceding the reconciliation year through December 31 of the reconciliation year.

PTR = Pre-tax return as described above.

ActNetDep = Actual net depreciation expense related to the average investment in QIP for the rate zone for the reconciliation year. Depreciation expense shall be calculated by multiplying the actual investment in QIP by plant account, net of retirements, by the approved depreciation rates for the respective accounts in which the specific items included in the average QIP investment are recorded.

QIPRev = Actual QIP revenues for the rate zone collected during the reconciliation year through the QIPS.

Rpy = The R component for the rate zone from the previous reconciliation year.

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

Opy = The sum of the O component and the calculated interest attributable to the O component, or the sum of any O components and the calculated interest attributable to the O components, included in the calculation of the QIP surcharge percentage during the reconciliation year.

EEA = Excess earnings amount calculated in accordance with subsections (a), (c), and (f) (4) of this Section. There will only be an EEA when the utility's actual rate of return for the reconciliation year exceeds the overall rate of return authorized by the Commission in the utility's last sewer rate proceeding.

- e) Any adjustment made by Order of the Commission under (b) or (c) above shall be included in the O component and be in effect for either 12 months or nine months, beginning on the next January 1 (if 12 months) or April 1 (if nine months) following the Order of the Commission, or such other period as the Commission may direct in the Order requiring that an adjustment be made.
- f) Each annual reconciliation shall include the following schedules:
 - 1) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the QIP costs for the reconciliation year;

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Original Sheet No. 25

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- 2) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the revenues arising through the application of the QIP surcharge during the reconciliation year;
- 3) A schedule showing, for each rate zone for which a QIP surcharge rider was in effect, the reconciliation component determined by the utility showing the amount to be recovered or refunded over a nine-month period commencing on April 1; and
- 4) Schedules showing the utility's calculation of actual operating income and 13-month average rate base for the reconciliation year by rate zone. This calculation of actual operating income and 13-month average rate base shall be adjusted for any applicable adjustments accepted by the Commission in the utility's last rate case. In calculating the amount of federal and State income tax expense reflected in operating income, the utility shall reflect as deductible interest expense for tax purposes the product that results when the weighted embedded cost-of-debt reflected in the overall rate of return calculation used in the utility's last rate proceeding is multiplied by the rate base for the applicable rate zone as shown in the annual reconciliation.

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

In the event that the actual rate of return for any rate zone exceeds the rate of return allowed in the utility's last sewer or sewer general rate proceeding, a schedule showing the extent to which revenues provided by operation of the QIP surcharge contributed to the difference between the actual and last-authorized rate of return also shall be provided. The amount of the revenues provided by the QIP surcharge that contributed to the actual rate of return exceeding the overall rate of return authorized by the Commission in the utility's last sewer and sewer rate proceeding shall be included as a credit in the calculation of the R component.

- g) The first reconciliation year shall begin on the effective date of the first QIP surcharge information sheet and end on December 31 of the calendar year in which the first information sheet became effective. Each subsequent reconciliation year shall end on December 31.
- h) When the utility files its annual reconciliation, the utility shall provide copies of the following items to the Commission's Manager of the Sewer Department and to the Commission's Manager of the Accounting Department.
 - 1) Copies of all workpapers pertaining to the reconciliation;
 - 2) A detailed summary of all invoices supporting the costs for eligible QIP surcharge projects;

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SANITARY SEWER SERVICE

QUALIFYING INFRASTRUCTURE PLANT SURCHARGE RIDER

- 3) Copies of the applicable general ledger or comparable material supporting the recovery of the QIP surcharge;
 - 4) A detailed worksheet showing the calculation of any utility-determined reconciliation component (R component) amount based upon the annual reconciliation; and
 - 5) Information regarding the prudence of the utility's investment in QIP.
-
- i) Amounts either collected or refunded through the O component shall accrue interest at the rate established by the Commission under 83 Ill. Adm. Code 280.70 (e) (1). Interest on the O component shall be applied from the end of the reconciliation year until the O component is refunded or charged to ratepayers through the QIPS.
 - j) If, for a rate zone, the annual reconciliation filed by a utility shows that the revenues collected by application of the QIP surcharge rider exceed actual QIP costs for three or more consecutive reconciliation years, the Commission may initiate hearings under Section 9-250 of the Act [220 ILCS 5/9-250] to determine whether the utility's QIPS rider for the rate zone should be canceled.

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